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As I See

THE INTERNATIONAL SITUATION AND REAL ESTATE

IT is quite difficult to tell at the present time whether we are still in a postwar period or whether we are now in a prewar period. While undoubtedly the great preponderance of probabilities is that any major war is still some years in the future, there is certainly a strong possibility that we may drift into a shooting war without too much advance notice. There is also a very strong probability that our expenditures for military and naval purposes will now be stepped up materially.

How will this change the outlook for real estate, and what policies should be followed in view of the present situation?

It seems to me that, while the worst we can expect is an atomic and bacteriological war, horrible beyond all description, the best we can expect is a sizable increase in defense appropriations. The probability is that this will unbalance the budget for the next fiscal year, resulting in income tax increases for 1949 offsetting to some extent any reduction for 1948 which can be passed over the President's veto. It may also bring about a renewal of some deficit financing, and with higher interest rates it might be quite difficult for the government to raise the necessary funds through the sale of bonds to the public, making necessary some further sales to commercial banks with the further inflationary effects which always accompany sales of this sort.

A small increase in our military appropriations, while inflationary in nature, would come at a period when many of the other forces have turned deflationary, and would probably only offset the downward drifts which would otherwise develop during the period of 1948. A very heavy increase in military appropriations would be so strongly inflationary that prices of most commodities and services could be expected to resume their upward movement, with the turning point of inflation beyond the horizon. A shooting war would be so inflationary that there is no question but that price and wage and profit controls would immediately be reinstated, with the eventual result that the dollar would lose a much larger percentage of its purchasing power.

If universal military training and the draft are reinstated, the surplus of manpower which is just starting to develop will be absorbed, and a manpower shortage in commerce and industry will again be apparent. This shortage, barring wage control, would result in a competitive bidding by employers for the insufficient number of employees available. It would also result in a loss in worker efficiency. Since the profit margin of most companies at the present time is not sufficiently high to pay an adequate return to capital and absorb further wage increases, this situation would inevitably result in higher prices for practically all commodities.

Should the international situation become more critical, there is always the possibility that the inflationary aspects of the problem will be recognized by a large enough percentage of the population to cause a flight from the dollar in an effort to turn money into tangibles. This would bring about a sharply accentuated demand for many commodities and would intensify the shortages and the price increases. The price increases would increase the amount of hoarding and inventory accumulation, which would still further intensify the shortage. In this way a whole new round of inflation could easily start on short notice.

What would be the effect of these possibilities on the various types of real estate?

Since the fall of 1946 our advice has constantly been to liquidate all single-family residences not occupied by the owner, with particular emphasis on older buildings. This advice was based on the assumption that scarcity prices for real estate would continue only so long as the scarcity continued, and with the rather firm belief that the scarcity would be over some time in 1950. It was also assuming that construction costs are now at the peak. If, however, orders for war materials are placed again in large quantities, many war workers would return to the cities, with the chance that the housing shortage would continue longer than our previous assumption. There would also be the probability that limitations would again be placed on building in order to conserve scarce materials and that this, together with a shortage of manpower, would make it impossible to alleviate the housing shortage in any reasonable period. Construction costs would increase further. Even obsolete housing would again increase in value under these conditions, and no type of housing would undergo any great drop in value during the next few years.

Rental housing would become quite a problem as war workers would much prefer to rent rather than to buy, but in case of war, rent controls would be continued with relatively little increase in the levels and with operating costs continuing to rise.

Vacant land suitable for residential building would not be used rapidly, and as a general thing would not be a good investment.

Store buildings would not increase in value in the immediate future, as the dollar volume of many retail establishments would not increase during the initial period of rearmament or war. Over the long period, however, the further inflation of the general price level would bring about a further increase in dollar sales, and therefore of values of this type of property.

In spite of the increased operating costs of office buildings which would accompany a resumption of war activities, the demand for office space by government and by war industries would increase still further, and the present scarcities of office space would be accentuated. Unless the square foot rentals of office building space were frozen, rents would continue to increase, increasing the capitalized value of the properties. The same thing would be true of hotels, as the demand for hotel space would increase at a time when no new hotels could be built.

Industrial buildings well located and modern would in many cases take on added value and the obsolete industrial buildings which would otherwise decline in value might take on a new lease on life for the next few years.

It seems to me that the wiser policy at the present time in regard to real estate is a do-nothing policy. If I owned single-family residences which I did not occupy myself, I would continue to own them in all cases except those buildings which are totally obsolete and which can be fully occupied only during a period of intense shortage. On the other hand, at the present time if I did not own real estate I would not buy it but would wait for further developments. If an actual shooting war gets under way, changes in values would come very slowly at first. I would then start to accumulate equities in various types of real estate in an attempt to conserve the purchasing power of my capital, but with the full realization that the conservation of capital in the light of another war would be a very difficult, if not impossible, job. Real estate, in my opinion, will not advance in price by as great a percentage as the dollar will shrink in value, and the only chance of keeping the purchasing power of one's capital even would be to buy on margin; in other words, to buy equities with rather large underlying mortgages. This would be a policy which would involve some risk, and only a portion of one's capital should be used in this fashion.

Those persons who followed our advice prior to the beginning of World War II and who purchased slim equities have experienced an increase in their capital more than sufficient to offset the decline in the purchasing power of the dollar. This next time, however, the problem will not be quite so simple.

Should Russia decide to precipitate a war, it seems to me that the strong probability would be that she would overrun western Europe, which could probably be done in a period of two to three months. We would immediately, of course, stop our exports of grain to western Europe and, as almost one-third of some of our grain crops are now being exported, this would result in surpluses overhanging our own markets, with an initial depressing effect on farm values. Cotton would also be adversely affected. This overhang, I believe, would be temporary and within a period of from one to two years the general inflationary effects of the war would again bring much higher prices for farm products with a higher price for farm lands. These changes, however, have never come rapidly, and probably would not come rapidly this time.

Fortunately, real estate moves slowly and there is no immediate necessity for taking sudden action. I think that the present time is a good time to follow a "watchful waiting" policy, ready to sell any remaining real estate if it becomes apparent that inflation has run its course and will not be resumed, ready to hold if it seems that inflation is going further, and even ready to buy on margin certain types of real estate if it seems that a major war will further destroy the purchasing power of the dollar. There is no need to hurry. Do not mistake movement for progress. Doing nothing until the best thing to do is apparent is the wisest policy.

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